

What you need to consider in order to comply with small business size requirements... under SBA's "relaxed rule" of affiliation.

INDUSTRY DAY III

Elizabeth A. Craig
Size Determination Specialist
SBA Office of Government Contracting/Area
4/Chicago

May 19, 2004

Size Standard

- The 40mm procurement will fall under NAICS Code 332993 with a corresponding size standard of 1,500 employees.

Because the dollar value of these 40 mm procurements is expected to exceed \$10 million, SBA's "relaxed" affiliation rule will apply.

The "relaxed rule" is found in the size regulations at 13 CFR 121.103(f)(3)(i).

What is the “relaxed rule”?

- The relaxed rule says that so long as each JV partner or party to a teaming arrangement *individually* qualifies as a small business, then the JV or teaming arrangement qualifies as small.

The regulation at 13 CFR 121.103(f)(3)(i) reads:

- (i) A joint venture or teaming arrangement of two or more business concerns may submit an offer as a small business for a Federal procurement without regard to affiliation under this paragraph (f) so long as each concern is small under the size standard corresponding to the NAICS code assigned to the contract....

Again,

- The “relaxed rule” means that so long as each JV partner (in the case of a joint venture) or team member (in the case of a teaming arrangement) *individually* qualifies as a small business, then the JV or teaming arrangement qualifies as small.
- In other words, a Large Business CANNOT be a member of a Joint Venture or a Teaming Arrangement—with only one exception involving 8(a) firms.

With the procurements being
Small Business Set-Asides,
What role can/will Large
Business play in the 40 mm
procurements?

- Large Businesses will be directed sources;
- Large Businesses can be subcontractors;
- Large Businesses can be part of an SBA-approved JV with an 8(a) firm—to be discussed in more detail later.

Large Business (LB) as Directed Source

- A LB cannot be a member of the JV or the TA, but a LB can be utilized as directed by the solicitation without causing size problems.

Large Business as Subcontractor

- Subcontracting with a LB is okay, but the prime, whether it's a single business or a JV or a TA, must be mindful of “ostensible subcontracting.”
- **os·ten·si·ble** *adj.*
 - Represented or appearing as such; ostensive:
 - *His ostensible purpose was charity, but his real goal was popularity.*
» From www.dictionary.com

What is Ostensible Subcontracting?

- A contractor and subcontractor are treated as joint venturers if the ostensible subcontractor will perform **primary and vital requirements** of a contract or if the prime contractor is **unusually reliant** upon the ostensible subcontractor. All requirements of the contract are considered in reviewing such relationship, including contract management, technical responsibilities, and the percentage of subcontracted work.
 - Ostensible Subcontracting:13 CFR 121.103(f)(4)

Seven-Factors Test

1. Which party chased the contract?
2. What degree of collaboration was there between the prime contractor and subcontractor on the proposal?
3. Which party possesses the requisite background and expertise to carry out the contract?
4. Who will manage the contract?
5. Are there discrete tasks to be performed by each party, or is there commingling of personnel and materials?
6. What is the amount of work to be performed by each party?
7. Which party performs the more complex and costly contract functions?

- The “seven factors” test is only one tool used by SBA to evaluate whether the relationship is a true prime/subcontractor relationship or a joint venture under the ostensible subcontractor regulation. It is not the exclusive test of the presence of unusual reliance. Ultimately, a finding of unusual reliance, which rises to the level of a joint venture affiliation, must be a reasonable conclusion based on the totality of the circumstances.

To learn more,

- Decisions made by the Office of Hearings and Appeals (OHA) in Washington can provide insight on “ostensible subcontracting” if you’re concerned. Go to: www.sba.gov/oha and then “search decisions.”
- Search using key words such as “ostensible subcontracting” or “totality of the circumstances” or “joint venture.”

Bottom Line: Ostensible Subcontracting with a LB is a problem.

- Why? Because ostensible subcontracting with a LB causes the prime, whether it be an individual small business, a joint-venture, or a teaming arrangement, to not be small and therefore not eligible for award of a small business set-aside procurement.

LB as part of an SBA-approved JV between an SBA-approved Mentor and 8(a) Protégé

- 13 CFR 121.103(f)(3)(iii) says: Two firms approved by SBA to be a mentor and protégé under 13 CFR 124.520 may joint venture as a small business for any Federal Government procurement, provided the protégé qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement and, for purposes of 8(a) sole source requirements, has not reached the dollar limit set forth in 13 CFR 124.519.

In plain English, this means...

- An 8(a) firm that meets the 1,500 employee size standard could enter into an SBA-approved mentor/protégé agreement with a Large Business mentor. The mentor and protégé can then form a JV—if approved by SBA—and then be eligible for award of a small business set-aside procurement or an 8(a) procurement.
- Technically, the JV is not an 8(a) participant and it doesn't apply for 8(a) certification, but the 8(a)JV is eligible to receive award of 8(a) procurements.

- This applies to Small Business Set-Aside (SBSA) procurements as well as 8(a) procurements.
- But remember, the mentor/protégé relationship has to get SBA approval, and then the JV agreement has to get SBA approval.
 - Can request both at same time
 - Request goes through the 8(a) firm's BOS.

- Mentors can have up to 40% equity position in protégé.
- Mentor can be large or small.
- To be a Mentor, a business must:
 - Show a profit for at least the last two years;
 - Possess good character;
 - Not appear on the debarred or suspended list;
 - Be able to impart value to the protégé through lessons learned and practical experience. Mentor can be large or small.

- If an 8(a) JV is formed, the 8(a) participant must perform a “significant” portion of the contract.
- If an 8(a) JV is formed, the 8(a) must receive at least 51% of the profits of the JV.
- Details of SBA’s 8(a) Mentor/Protégé Program can be found at 13 CFR 124.520.
- 8(a) firms should consult their BOS at their local SBA office.

8(a) Procurements

- For those procurements that are 8(a) set-asides, award can only be made to either:
 - an 8(a) firm; or
 - an SBA-approved 8(a) Joint Venture.

How do you determine if a JV or teaming arrangement meets the “relaxed rule” for size?

- To see if a JV or teaming arrangement meets the “relaxed rule,” each member of the JV or teaming arrangement will need to determine if it qualifies as a “small business.”
- To calculate number of employees, each party to the JV or teaming arrangement must include not only its own employees, but also the employees of its own affiliates.
 - The calculation includes ALL employees of ALL affiliates--WORLDWIDE.

What is an affiliate?

- In plain English, affiliates are any other businesses owned and/or controlled by the same person/people/group/entity/etc.--regardless of the line of work they're in.
- For the official, regulatory definition of affiliate, see 13 CFR Part 121.103.

Calculating Number of Employees

13 CFR 121.106

- In calculating “number of employees,” SBA counts full-time, part-time and temporary employees the same.
 - Calculation does not use full-time equivalents (FTEs);
 - One part-time employee counts the same as one full-time employee who counts the same as one temporary employee;
 - Count the employees by pay period.

Calculating Number of Employees, continued

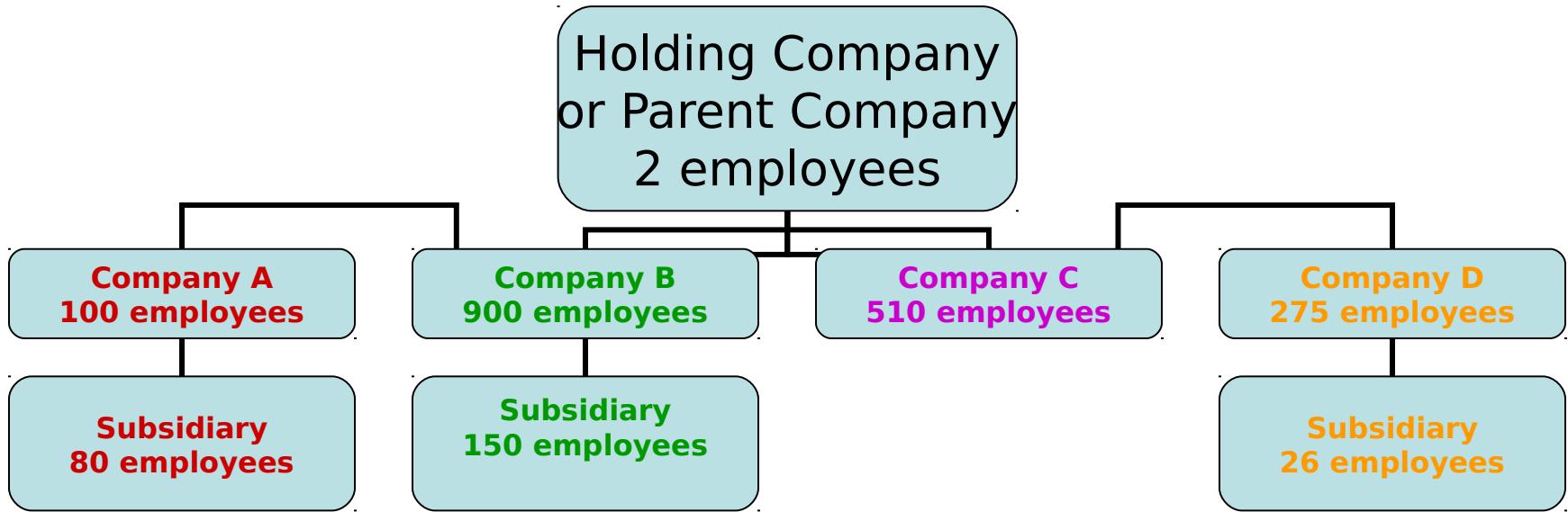
- A business’ “number of employees” is a twelve month average based on the number of people employed by pay period during the last 12 completed calendar months prior to when you submit your written small business self-certification as part of your initial offer including price.

(13 CFR 121.404)

For instance...

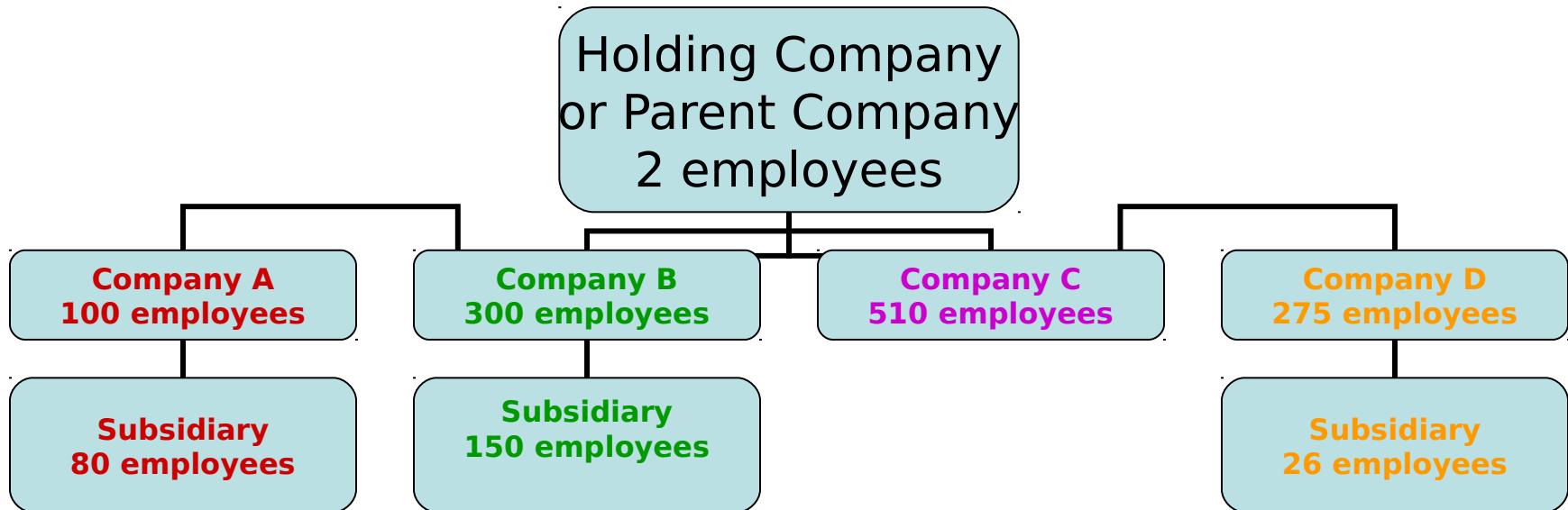
- If you submit your initial offer including price in October 2004, your number of employees is calculated by averaging the number of employees during each pay period from October 2003 through September 2004.
- Need to be small at the time of initial offer including price.

Example: Not Small



None of the businesses in this diagram can submit an offer for the SBSA or 8(a) procurements. They also can't be part of a JV or TA. Why? Because each of these businesses is a LB because each one of these businesses, when combined with its affiliates, exceeds 1500 employees.

Example: Small



Each and every one of these businesses qualifies as a small business under the 1500 employee size standard. Any one of these businesses could be the prime or participate in a JV or TA as a small business.

Hypothetical JV or teaming arrangement between 4 businesses: Company A, B, C, and D

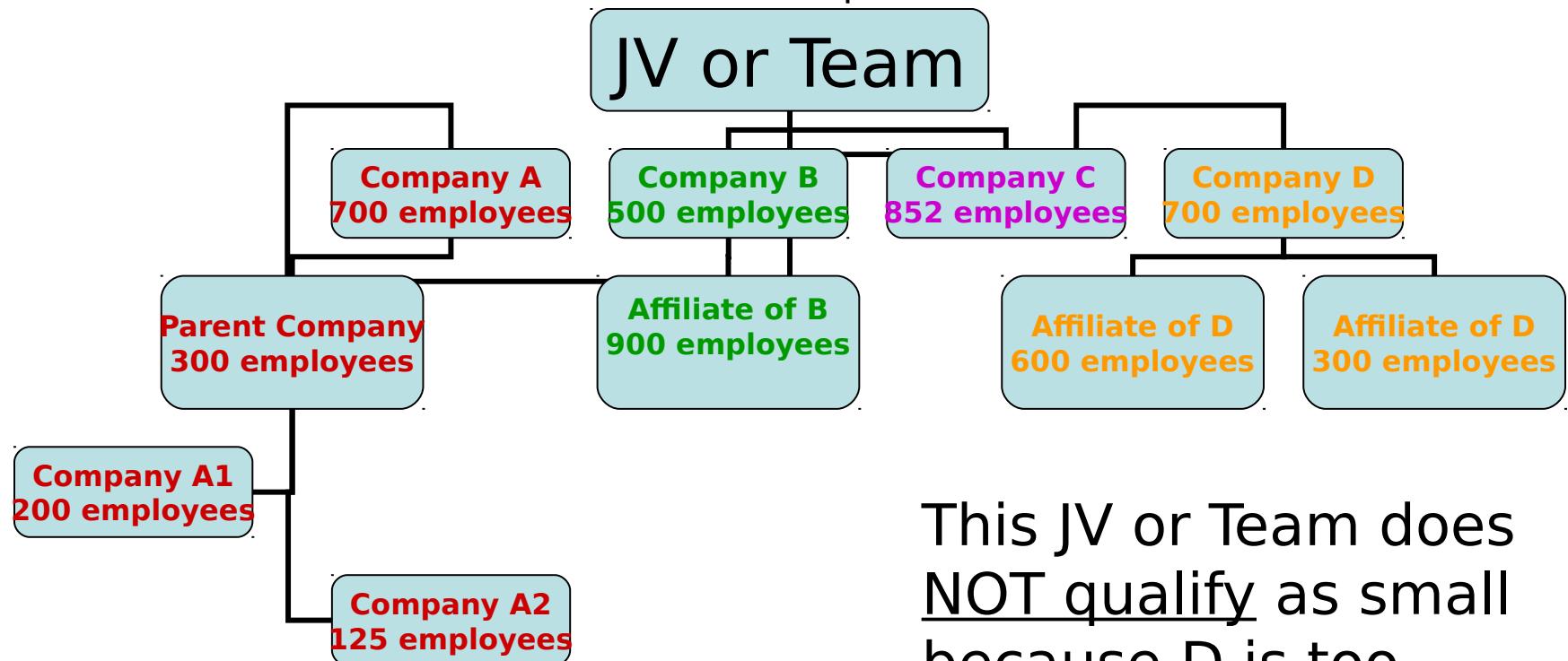
Company A and its three affiliates average 1325 employees, therefore it's small;

Company B and its one affiliate average 1400 employees, therefore it's small;

Company C has no affiliates and averages 852 employees, therefore it's small;

Company D and its two affiliates average 1600 employees, therefore it's NOT small.

Since all 4 parties to the JV do NOT individually qualify as small, the JV Offeror does NOT meet the "relaxed rule" and is NOT eligible for award of a small business set-aside procurement.



This JV or Team does
NOT qualify as small
because D is too
large.

Hypothetical JV or Teaming Arrangement consisting of a JV with 4 members:

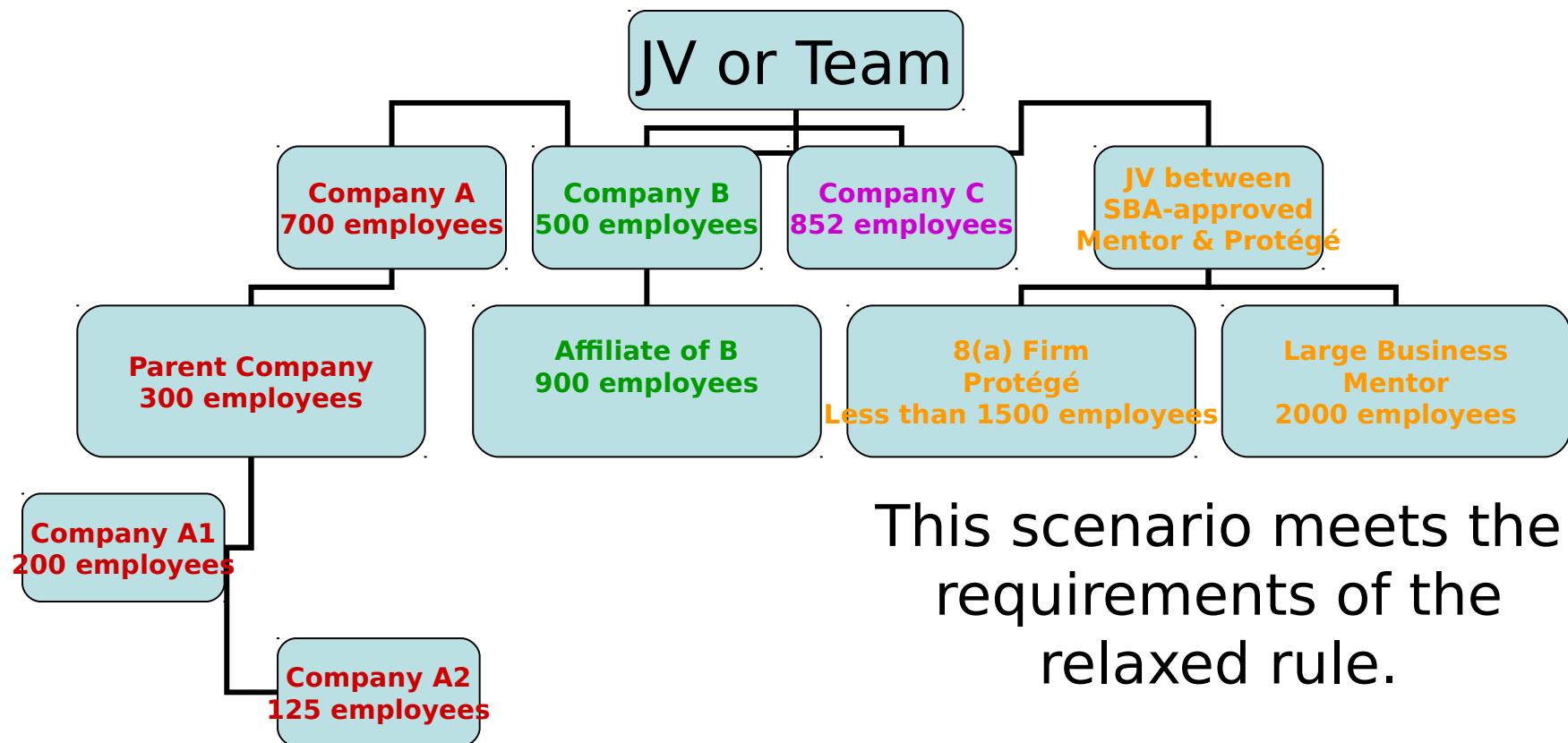
Company A and its three affiliates average 1325 employees, therefore it's small;

Company B and its one affiliate average 1400 employees, therefore it's small;

Company C has no affiliates and averages 852 employees, therefore it's small;

If the JV between the SBA-approved mentor & protégé is approved by SBA, then it qualifies as small.

Since all 4 members of the JV individually qualify as small, the JV Offeror meets the "relaxed rule" and is eligible for award of the small business set-aside procurement.



What's the Difference between a Joint Venture and a Teaming Arrangement?

- A Joint Venture (JV) can be an informal arrangement or it can be in the form of a new legal entity, such as an LLC. The contract would be awarded in the name of the JV.
- A Teaming Arrangement (TA) is really just a glorified subcontractor relationship. The contract would be awarded in the name of the team leader.

If you're considering a JV or TA:

- Suggest you consult your attorney before deciding how to structure your group.
 - Need to consider things such as, what if a member goes bankrupt, gets bought out, no longer wants to participate, etc.
- Both the JV (whether it's informal or separate legal entity) and the TA offer the same size benefits.

Does SBA approve Teaming Arrangements or Joint Ventures?

- SBA does not approve either Teaming Arrangements or Joint Ventures—except for those involving 8(a) firms.

JV or TA involving an 8(a)

- If it's for an 8(a) procurement, SBA must *approve* the agreement.
- If it's for a non-8(a) procurement, SBA must be *notified*, but SBA does not approve the agreement.
 - 8(a) JV or TA agreements would be handled through the 8(a) firm's BOS at the District Office level.

Topics you might cover in a Joint Venture or Teaming Arrangement:

- Purpose of the agreement;
- Scope of the agreement;
- Name, if it's a JV;
- Pre-Award Costs;
- Pre-Award Negotiations;
- Duties & Responsibilities Upon Award;

JV or TA topics, continued

- Proportionate Interest;
 - If contemplating an SBA-approved 8(a) JV between an SBA-approved mentor and protégé, know that the 8(a) firm must receive at least 51% of the profits.
- Management of the JV or team;
- Authorized Representatives;
- Working Capital;
- Insurance;

JV or TA topics, continued

- Borrowing funds;
- Disbursements & Division of Profits;
- Distribution of JV assets;
- Burden of losses;
- Assignments or Pledges;
- General & Administrative Overheads;
- Right to withdraw;

JV or TA topics, continued

- Amendments to the agreement;
- Notice;
- Disputes / Arbitration; and
- Jurisdiction.

Again, I suggest you consult legal counsel. These are just *some* of the topics you may wish to cover in an agreement.

Miscellaneous Questions

- Can two large businesses form a Joint Venture with less than 1,500 employees and qualify for these SBSA procurements?
 - NO
- Can a large business and a small business form a Joint Venture and qualify for these SBSA procurements?
 - NO

Limitations on Subcontracting

- Because these are Small Business Set-Aside procurements, Limitations on Subcontracting will apply.
- The Limitations on Subcontracting can be found at FAR 52.219-14.
- For supplies, the limitation reads as follows:

Limitation on Subcontracting (LOS) for Supplies

By submission of an offer and execution of a contract, the Offeror/Contractor agrees that in performance of the contract in the case of a contract for ...

Supplies (other than from a nonmanufacturer of such supplies), the concern (read: award recipient) shall perform work for at least 50 percent of the cost of manufacturing the supplies, not including the cost of materials.

LOS: Cost of Manufacturing

- Those costs incurred by the firm in the production of the end item being acquired. These are costs associated with the manufacturing process, including the direct costs of fabrication, assembly, or other production activities, and indirect costs which are allocable and allowable. The cost of materials, as well as the profit or fee from the contract, are excluded.

LOS: Cost of Materials

- Includes costs of the items purchased, handling and associated shipping costs for the purchased items (which includes raw materials), off-the-shelf items (and similar proportionately high cost common supply items requiring additional manufacturing or incorporation to become end items), special tooling, special testing equipment, and construction equipment purchased for and required to perform on the contract. In the case of a supply contract, the acquisition of services or products from outside sources following normal commercial practices within the industry are also included.

LOS: Off-the-Shelf Items

- An item produced and placed in stock by a manufacturer, or stocked by a distributor, before orders or contracts are received for its sale. The item may be commercial or may be produced to military or Federal specifications or description. Off-the-shelf items are also known as Nondevelopmental Items.

LOS: Subcontracting

- That portion of the contract performed by a firm, other than the concern awarded the contract under a second contract, purchase order, or agreement for any parts, supplies, components, or subassemblies which are not available off-the-shelf, and which are manufactured in accordance with drawings, specifications, or designs furnished by the contractor, or by the government as a portion of the solicitation.

Subcontracting, continued

- Raw castings, forgings, and moldings are considered as materials, not as subcontracting costs. Where the prime contractor has been directed by the Government to use any specific source for parts, supplies, components subassemblies or services, the costs associated with those purchases will be considered as part of the cost of materials, not subcontracting costs.

Subcontract Costs

- The subcontract costs are the entire costs spent on subcontracting.
 - There are no adjustments or calculations to be done to the subcontracting costs
 - (i.e., you do not get concerned with your subcontractor's costs of manufacturing or cost of materials, etc.)

LOS: Offer of \$100

- \$ 5 Fee
- \$10 Profit
- \$40 Materials
- **Subcontracting**
 - \$15 Directed Source
 - \$15 Other Subs
- **\$15 Everything Else**
- In compliance with LOS clause b/c doing 50%. (15/30)
- \$ 5 Fee
- \$10 Profit
- \$40 Materials
- **Subcontracting**
 - \$15 Directed Source
 - \$20 Other Subs
- **\$10 Everything Else**
- Violation of the LOS clause b/c only doing 33%. (10/30)

The LOS Clause:

By submission of an offer and execution of a contract, the Offeror/Contractor agrees that in performance of the contract in the case of a contract for ...

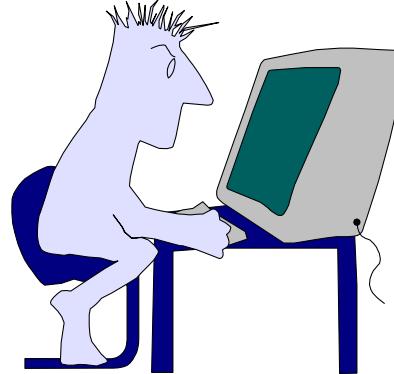
Supplies (other than from a nonmanufacturer of such supplies), the concern (read: award recipient) shall perform work for at least 50 percent of the cost of manufacturing the supplies, not including the cost of materials.

- Where an offeror is exempt from affiliation under [the relaxed rule] and qualifies as a small business concern, the [LOS performance of work requirements] apply to the cooperative effort of the team or joint venture, not its individual members.

- Work to be performed by subsidiaries or other affiliates of a concern is not counted as being performed by the concern for purposes of determining whether the concern will perform the required percentage of work.

- The Limitations on Subcontracting apply to the contract—not to individual line items.

Websites



To find the Code of
Federal Regulations (CFR) on-line,
visit:

- http://www.access.gpo.gov/nara/cfr/waisidx_03/13cfrv1_03.html

Size regulations -- 13 CFR Part 121

8(a) regulations -- 13 CFR Part 124

Limitations on Subcontracting - 13 CFR Part
125.6

Elizabeth Craig
Size Determination Specialist

312-353-7674

elizabeth.craig@sba.gov

SBA Office of Government Contracting/Area 4
500 W. Madison Street, Suite 1250
Chicago, IL 60661

Illinois, Indiana, Iowa, Kansas, Michigan,
Minnesota, Missouri, Nebraska, North Dakota,
Ohio, South Dakota, and Wisconsin

<http://www.sba.gov/size/indexcontacts.html>

- CT, ME, MA, NH, NJ, NY, RI, VT
 - Boston
- DE, DC, MD, PA, VA, WV
 - Philadelphia
- AL, FL, GA, KY, MS, NC, SC, TN
 - Atlanta
- AR, CO, LA, NM, OK, TX
 - Fort Worth
- AK, AZ, CA, HI, ID, MT, NV, OR, UT, WA, WY
 - San Francisco